After covering questions 1 to 24, an investor may conclude that a stock is QGLP compliant. However, the world of business and the stock markets are too dynamic. Hence, it is critical to assess the risks that a company faces.

Q25 What can go wrong with the company narrative and numbers?

We list out risks under two heads –
(1) Business Risks and
(2) Management Risks.

Business Risks

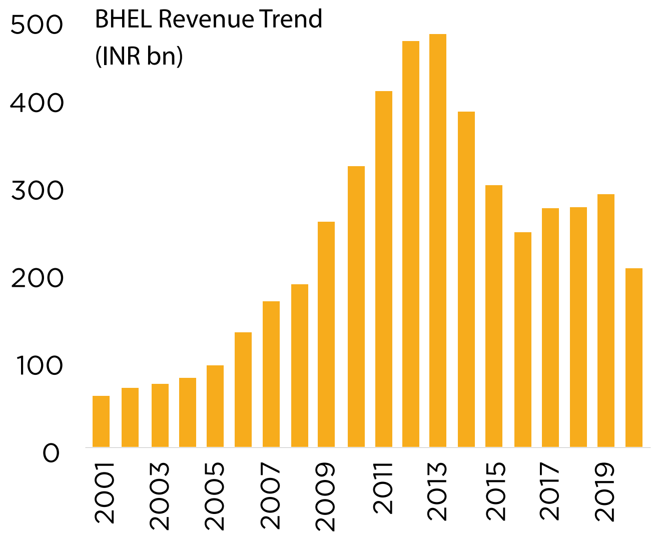
A company has to deal with a host of operational risks e.g. rise in raw material prices, labor strikes, fire in the plant, etc. These will vary from company to company. However, the more structural risks are -

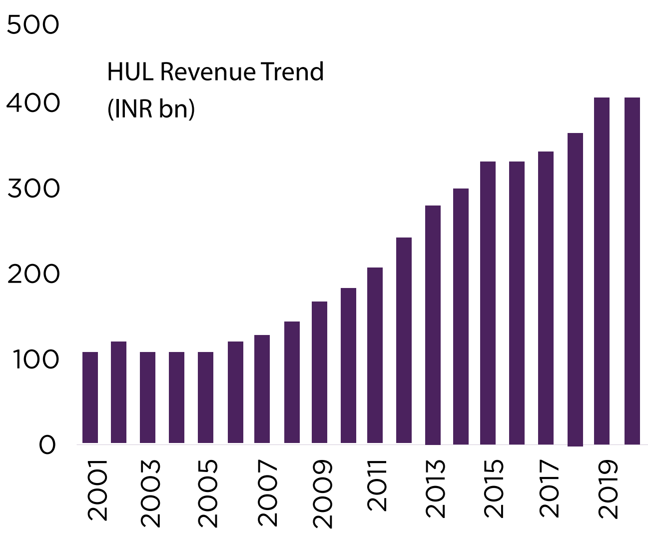
- Economic and/or sector slowdown
- Adverse change in competitive landscape and
- Adverse change in regulatory framework.

Economic and/or sector slowdown

This is the most common risk facing every single company. However, some sectors/companies are less prone to slowdown than others. Typically B2C (business-to-consumer) companies tend to be less vulnerable to economic and business cycles than B2B (business-to-business) and B2G (business-to-government) companies.

BHEL (B2B) is vulnerable to economic cycles … **… Hindustan Unilever (B2C) is not**



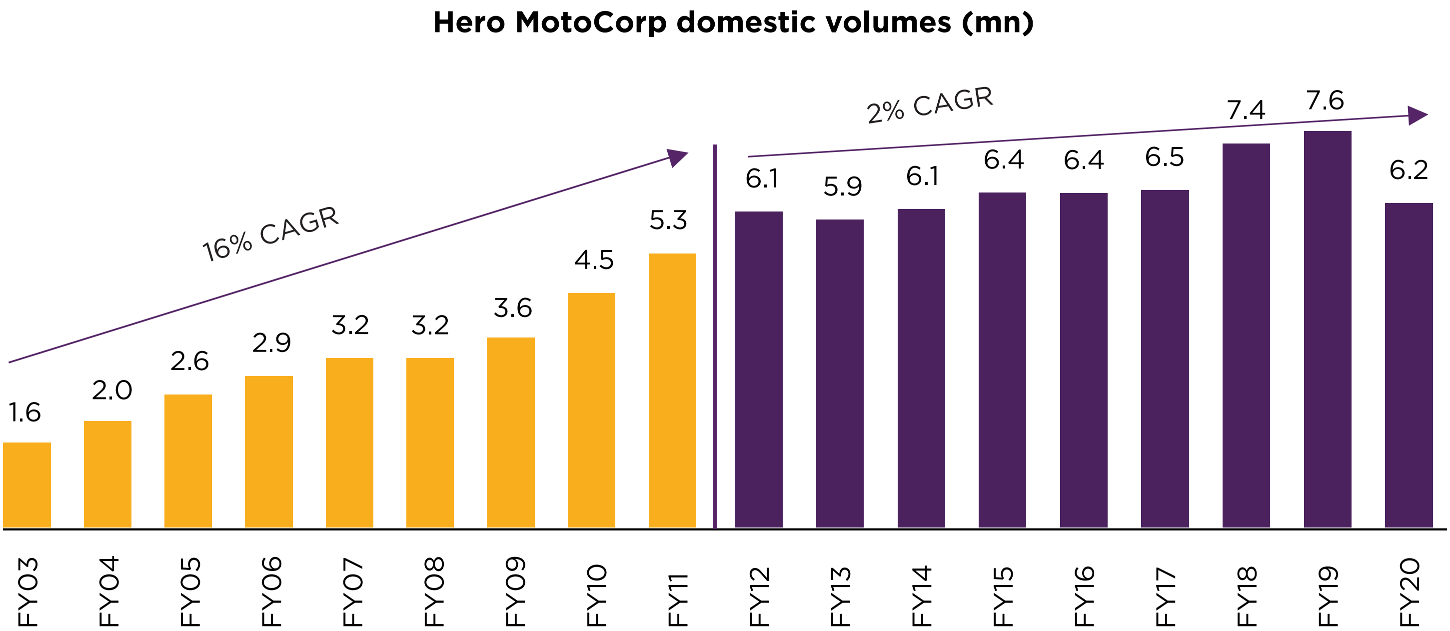


Adverse change in competitive landscape

Competitive landscape tends to be structural. However the occasional change in competitive landscape, if adverse, could significantly affect company fortunes. The disruption caused by Reliance Jio in the wireless telecom sector is obvious. But there can be not-so-obvious changes as well.

Consider the case of **Hero MotoCorp**. In December 2010, the company (then, Hero Honda) separated from its joint-venture partner, Honda Japan. Honda thus became a formidable competitor in the 2-wheeler sector. From FY03 to FY11, Hero clocked volume CAGR of 16%. For the next 9 years post break-up, Hero's volume CAGR is a mere 2%. The competitive landscape has changed adversely forever.

Hero MotoCorp has been impacted by adverse change in competitive landscape



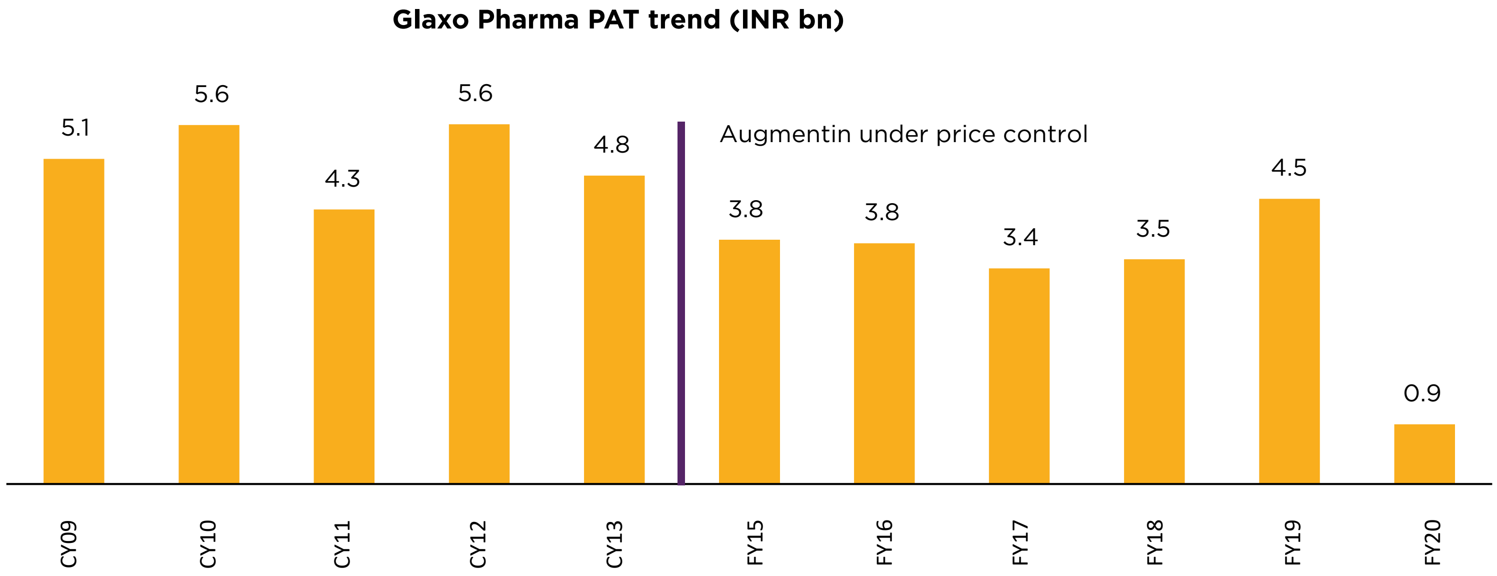
Technological/Digital disruption: A new and rapidly growing change in the competitive landscape is that of technological/digital disruption. Virtually every business – be it financial services or retailing or autos – is vulnerable to this risk. For instance, Bajaj Finance's explosive growth is largely attributable to its significant investment in fintech (financial technology). The competitive landscape for brokerages has turned adverse with the onset of digitally-led discount brokerage companies like Zerodha. Likewise, ICE (internal combustion engine) based auto manufacturers are highly vulnerable to electric vehicle technology.

Adverse change in regulatory framework

Government regulations can make or mar the fortunes of sectors and companies.

Example: In mid-2014, the Indian government introduced price control on Glaxo Pharma's flagship product Augmentin. Since then, Glaxo Pharma has not been able to raise its profit higher than the CY13 levels.

Glaxo Pharma profits hit by government regulation on drug prices



Management Risks

The major risks here are -

- Capital misallocation.
- Key-man risk
- Succession risk

Capital misallocation

This is a major risk as minority shareholders have virtually no control over how a company's management decides to allocate capital. Managements may use the company's cash flow towards empire-building through massive capex or mega acquisitions, to the detriment of shareholder value. Most mega acquisitions in the last 15 years have not created adequate returns to shareholders, as tabled below.

Post major acquisitions, shareholder return is muted at best

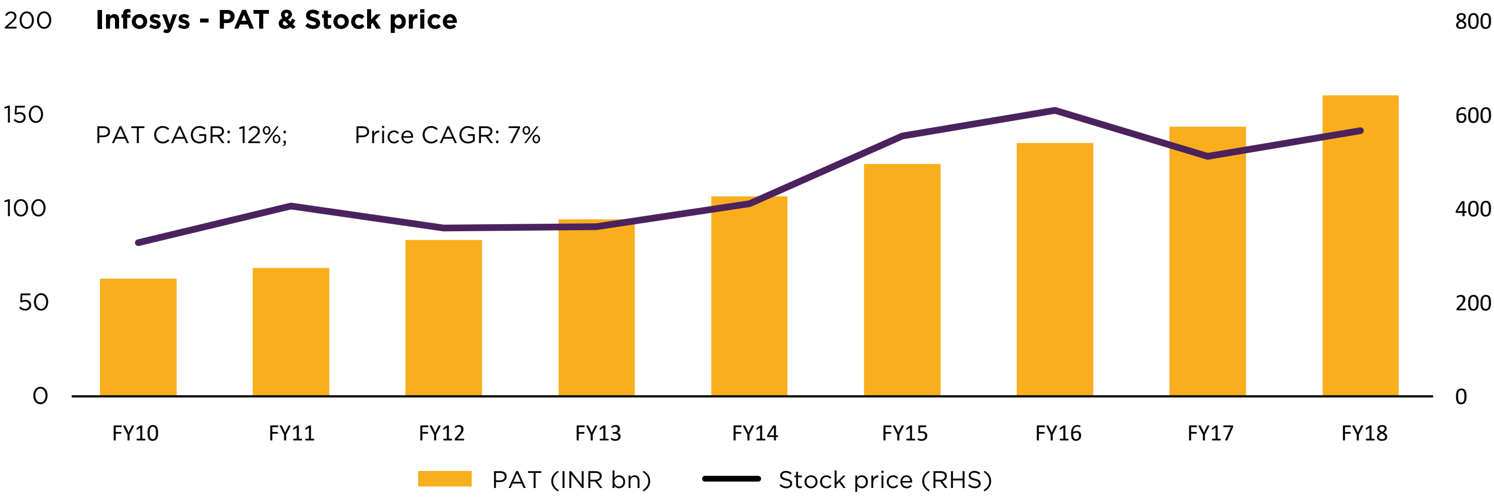
Acquirer	Acquiree	Date	Return CAGR 3 years post acquisition
Indian Hotels	Ritz Carlton, Boston	Jan-07	-11%
Tata Steel	Corus, UK	Jan-07	12%
Hindalco	Novelis, USA	Feb-07	5%
Suzlon	REpower, Germany	Jun-07	-33%
Bharti Airtel	Zain, Africa	Jun-10	3%
Mahindra & Mahindra	Ssyangyong, Korea	Jan-13	11%
Sun Pharma	Ranbaxy, India	Apr-14	1%

Key-man / Succession risk

Many times, the fortunes of a company depend on the key-man i.e. person at the helm of affairs. His departure from the company may adversely affect company performance. A related risk is whether the company manages to get the right successor to its current leader.

Example: Infosys struggled with succession for almost 9 years since June 2009 post the tenures of Narayan Murthy and Nandan Nilekani. Now, Nandan Nilekani is back as Chairman of the Board.

During its succession struggle, Infosys's fundamental and stock performance was muted



In closing

Use the questions and frameworks here to arrive at your own checklist

- Equity investing is complex and multivariate. A checklist is an excellent tool to bring discipline to the stock picking process.
- No investment checklist can be cast in stone. It needs to be continuously updated based on the learnings from its application.
- We believe the 25 questions here and the 25 related frameworks are a good starting point for an investor to arrive at their own checklist over time.